United States Court of Appeals

for the Second Circuit

APPELLANT'S PETITION FOR REHEARING

75-6080

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

DOCKET 75-6080

Plaintiff-Appellee

v

BERNARD JAY COVEN,

Defendant-Appellant

On Appeal From the United States District Court for the Southern District of New York

o

APPELLANT'S PETITION FOR REHEARING

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Pursuant to the provisions of Rule 40 of the Federal Rules of Appellate Procedure, petitioner BERNARD JAY COVEN, appellant herein, respectfully petitions the judges of this honorable Court for a rehearing of the appeal in the above entitled cause. As further, and alternative relief, pursuant to the provisions of Rule 35 of the Federal Rules of Appellate Procedure, petitioner respectfully suggests that the within cause is appropriate for consideration on rehearing by the judges of this Court convened en banc, and in support of the foregoing and of this suggestion, the petitioner respectfully shows:

1. The Court based its opinion affirming a portion of the order of the District Court on an inadvertent misunderstanding of various facts of this case, to wit:

(a) Throughout the opinion of the Court it was

stated that the petitioner "took the position...that the underwriters might deposit funds "net" i.e. after deducting their commissions." (Slip op. p.3223,3224,3237) And, the Court added, that the shortfall in the escrow account "was due to their practice of remitting funds "net". Aside from the final check of Carlton Cambrige at the closing this was not the position taken by the appellant. Up to the time of the closing in escrow on June 12 the only funds that were remitted net to the escrow fund was by a member of the selling syndicate of the co-underwriter, Gotham Securities, who had deducted its commissions of $1,582.50 (789a). Gotham paid directly into the bank and appellant had no way of determining that that was being done, nor did he consent or authorize it. Stevens, Jackson, Seggos, the counderwriter deposited all of its collected funds without deduction. With the exception of the last check mentioned above all of the deposits of Carlton Cambrige into the account were gross funds. (Undisputed Facts #52,53 at 39a)/and appellee's brief at p. 11. Further with the exception of the final check at the closing there is not a single shred of evidence in the case that appellant authorized, permitted or consented to the depositing of "net funds". The Court was possibly mislead by the appellee's misuse of the testimony of Dallal, an officer of the escrow bank. On direct, Dallal was asked a rather ambiguous question "Did anyone ever inform you that less than all of the funds would be deposited in the escrow account" Dallal resonded, "yes"

and that it was appellant or someone in appellant's office. But was the witness talking about "net funds" or the minimum of the underwriting. The bank was escrow agent only for the minimum. When the witness was pressed to be more "precise" (277a) and replied that he had been told that the minimum had been sold and that the underwriters "would be forwarding the proceeds to us". Again, the witness was pressed to respond to what was said and what his response was. He testified that "the person calling indicated that the offer of three million shares had been sold and that an opinion of counsel would be forthcoming" (279a). When pressed when this was he replied that it could have been any day after May 30 (280a). He then recalled several aborted attempts at a closing in June and finally got down to June 12 (281a).

(b) The opinion of the Court repeats the statement of the District Court that appellant "had no informed basis for his catagorical statement (that 3,075,000 shares were sold) and that none appears in the record". Coven testified that "The information was obtained from Stevens, Jackson & Seggos and Carlton Cambrige (the underwriters)" (52la). The Court inadvertently overlooked the curious coincidence that <u>both</u> co underwriters stopped soliciting customers for the new issue on May 29. (6la, 42la). Ziffer of Stevens, Jackson Seggos testified that he informed appellant as to the number of shares that been sold by that underwriter on or before May

29th (421a). The number reported was the similar amount of shares stated in its letter to the escrow bank (789a) so that Carlton Cambrige was well aware as early as May 29 as to the number of shares sold by the co-underwriter. Further, prior to the closing of June 12 Carlton had deposited to the escrow bank funds sufficient to cover 1,984,600 shares 1/. It ordered from the Transfer Agent 2,724,000 shares (807a). A simple subtraction of these two numbers plainly indicate did not on June 15 add 1,000,145 shares in street name as suggested. Further Coven's letter was dated June 13, subsequent to the abovementioned deposits and supports appellant's statement that he received his information from the underwriters as to the number of shares sold. As it further turned out, Carlton Cambrige had not sold 2,724,000 shares but had sold 2,727,000 and Stevens Jackson had sold 346,000. This error of 1500 shares was brought to light in the bank's counting and distribution of stock certificates delivered by the transfer agent on or about June 19, five days after Coven's letter (67a). This difference of 1500 shares is the difference between the

1/ 5/18 $27,320; 5/22 $21,650 (39a) and between June 7 and June 9 $58,376; $40,000, $23,140 and $28,000 (Appellee's brief p. 11) The finding of the District Court as to the number of shares sold prior to June 12 is plainly erroneous (66a). This Court inadvertently repeated that error. Another error inadvertently repeated by the Court is that Carlton Cambrige's last check was in the sum of $31,493.75. The amount was $31,503.75. The bank deducted $10 as a collection fee. This $10 accounts for 100 shares at 10 cents, the underwriting price.

the number of shares actually delivered to the underwriters, 3,073,500 and the number in appellant's letter of June 13.

(c) This Court's opinion inadvertently states that appellant's letter of June 13 gave the escrow bank assurance "that the underwriters had in fact deposited receipts "net" in accordance with the appellant's position". The facts are however, that on June 12 at the bank Carlton Cambrige delivered its letter (788a) and the co-underwriter delivered its letter on June 13 (789a). Coven's letter merely authorized the Bank to pay a portion of the funds on hand to the underwriter Stevens Jackson Seggos as commissions and the balance to his client.

(d) This Court inadvertently overlooked the fact that appellant has no way of determining whether the sales made by underwriters are bona fide and could not possibly determine this. The determination of whether sales were bona fide made is not affected by whether the escrow fund had the full $300,000 or not. Further, the bank was entitled to receive only the minimum portion of the underwriting and it seemed obvious at the time that additional funds would only result in an exchange of checks at the closing. This was the argument of the Bank (410a) which the District Court apparently found appealing in releasing this defendant from liability. The Court inadvertently overlooked the facts that the Bank was the only person to have copies of all confirmations of both underwriters and the names and addresses of every buyer. In addition, the Commission had arranged to receive bi-weekly reports of all sales from the underwriters.(413a). The attorney for the issuer did not have the information or facilities of either

the bank or the Commission.

(e) The destruction of the records of Carlton Cambrige (Slip op. p. 3236) came to light long after the issue was over and after the instant action had commenced, or perhaps, never revealed, during the investigation after the issue, and the possible loss of records was not a factor that the attorney for the issuer had to throw into the scale in making on the scene legal decisions.

(f) The Court inadvertently did not consider that there were ambiguities in considering the escrow agreement with the underwriting agreement and prospectus statements. Further, the determination of when an issue is"sold" was not definitively stated until the Release of July 11, 1975 requiring that it be"fully paid for" (Slip op. 3236 n.16), e.g., not when an obligation to pay has arisen. The Commission conceded that they had had an opportunity to clarify the Dennison issue in this respect but had not done so (411a). The matter set forth in italics in the Court's opinion p.3232 is historical boiler plate to prevent partial payments by the escrow agent and has no application to the deposit of the minimum in the manner suggested by the Court.

(g) The Court inadvertently overlooked the fact that $1,000 was deposited in the escrow account on June 15th, three days after the closing (769a). This was deposited by a member of the selling syndicate of Stevens Jackson Seggos

and the shares represented by this deposit were included in appellant's computation of shares sold given twoo days earlier. This is additional evidence that appellant's calculations were derived from underwriter sources.

2. The appellant, contrary to the Court's opinion was not found to have aided and abetted a violation of §17a of the 1933 Act, with respect to the escrow fund. The District Court found that the violation of Rega and Carlton Cambrige with respect to that portion of the case was a violation of Rule 10b-9 (80a-82a). The injunction against the appellant with respect to the charge of aiding and abetting that violation is couched in the precise language of 10b-9 (47a). This appeal was taken prior to the ruling in Ernst & Ernst v Hochfelder and the Commission's claim that such was the equivalent of 17a was an afterthought to meet that decision. The only cause of action in plaintiff's complaint upon which the relief was derived was the Fourth Cause of Action (18a) which charged the violation of Rule 10b and 10b-9. The injunction with reference to the escrow fund release contains no §17a language and was plainly not intended to enjoin a violation of that section. The Court in this Circuit should determine in this action that scienter is required for Securities Exchange Commission injunctions based upon 10b and 10b-9.

3. This Court having mistakenly noted that appellant was enjoined from aiding and abetting a violation of §17a with respect to the escrow account has further inadvertently sought to justify its position by erroneously citing subsection (2) as the subsection upon which the District Court acted. With respect to the escrow matter the Commission did not contend, and the Court did not find a violation of §17a(2); and of course, the appellant was not enjoined therefor. More closely to the injunction granted with respect to the escrow account is subsection (3), assuming arguendo that §17a is applicable at all. The language of that subsection is not significantly different from that of 10b-9. Sanders v John Nuveen & Co, Inc., 554 F. 2d 790 (7th Cir. 1977). In Sanders, in which the Commission participated as Amicus Curiae, the Court held proof of scienter is "unquestionably required" with reference to subsection (3) of §17a. In the light of Hochfelder the Court said an action under §17a cannot be premised upon negligent wrongdoing. The argument of the Court that the "clear import" of the critical phrase in subsection (3) "operates as a fraud" refers to the effect of misleading conduct and not to the culpability of the acting party is not supported in view of the fact that the entire phrase of subsection (3) includes the word "deceit" and any conduct which would operate as a fraud or deceit by definition would arise from "fraudulent conduct". The Court's comment to

to the article of Justice Douglas before he became a Justice of the Supreme Court in 43 Yale L.J.171,181(Slip Op. 3233) is not supportive as the comment has reference to subsection (2) of §17a.

4. The Court in its opinion (Slip Op. 3232 n. 12) has adverted to conflicting decisions in other circuits with respect to the applicability of scienter to §17a violations and to the particular subsections applicable. It is respectfully submitted that the policy of this Circuit should be determined by the Court en banc.

5. In any event it is submitted that appellant could not have concluded that his conduct was likely to be used in furtherance of illegal activity. If in fact sales made by Carlton Cambrige were not bona fide there was no method by which appellant could make that determination nor was it shown in any manner that the appellant was aware that any of the sales of Carlton Cambrige were not bona fide. When Carlton Cambrige ordered street name certificates this was done directly through the transfer agent and with the knowledge of the bank and without the knowledge of appellant. The Court inadvertently overlooked the fact that Dennison's president authorized the issuance of shares without consulting the appellant (159a,160a,763a).

6. The Court states in its opinion (p.3238) that the appellant's writing of the letter of June 13

amounted to a "reckless disregard" of a kind sufficient to support a finding of scienter. In this, the Court is, inadvertently, in error. As noted above appellant's information was obtained from the underwriters. Next, the bank was basically interested in the precise number of shares sold but whether 3,000,000 shares were sold. The bank did not rely upon the precise figure of 3,075,000 shares given by appellant. Indeed, after the Bank counted the shares it found that only 3,073,500 had been issued. The bank relied upon its own figures. In this it had confirmations, names of customers, all of which it could easily match up with the shares issued and the original issue sheets of the transfer agent. It was to the bank that the issuer turned to provide the information for its authorization to the transfer agent to issue shares (763a). Dennison's letter stated it had received consideration for 3,073,500 shares, the bank's figure. Further, the bank consulted its own attorneys before releasing any funds (794a).The usual closing arrangements for an underwriting is that the issuer upon receiving his funds issues a "window ticket" to the underwriters in effect an authorization to order from the transfer agent a specific number of shares. In the instant case the bank took on added responsibilities by accepting the delivery of stock certificates and in making the comparisons with its own records.

Coven's letter was not only not used in furtherance of illegal activity but in fact was not used at all. The statement as to the number of shares sold was not relied upon and the balance of the letter was information already in the possession of the Bank and in the letter of Stevens Jackson Seggos (789a) received by the Bank. In addition, the letter of Carlton Cambrige was typed at the Bank at the request of the Bank and the appellant had no participation in it (788a). The letter of Coven can hardly be equated with the letter written by the attorney in Spectrum, as was suggested by the Court (3238). It is respectfully submitted that while there can be no litmus paper test of what constitutes "reckless" it must be such conduct equivalent to knowledge, closely approaching that which attatches to conscious deception See Sanders v John Nuveen & Co., Inc. cited supra and Frank v Midwestern Oklahoma Development Authority, Fed Sec. L. Rep. ¶85,786; Steinberg v Carey, Fed. Sec. L. Rep. ¶96,215 (SDNY 1977).

It also may be noted that the District Court in finding no 10b-9 violation on the part of the Bank stated that the Bank had no reason to suspect "that the figures submitted to the transfer agent by Rega were in part contrived" (93a). It is difficult to see how the appellant could be in a superior position to know.

7. It is further submitted that if rehearing is denied and rehearing en banc is denied the order of this Court should be modified so as to permit the District Court to determine whether in the light of the reversal in part herein, an injunction is warranted under the circumstances with respect to the remaining charged violation.

WHEREFORE, appellant prays that a rehearing be granted, or that a rehearing en banc be granted, or that the order of this Court be modified so as to include an instruction that the District Court determine in the light of the reversal of a portion of its judgment whether an injunction is warranted against the appellant in the circumstances.

BERNARD JAY COVEN P.C.

By _____
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Member of the Firm
777 Third Avenue
New York, New York 10017
758 7090 (212)

The undersigned hereby certifies that the foregoing petition for rehearing is not frivolous and is presented in good faith and not for delay.

_____
BERNARD JAY COVEN
of Counsel

STATE OF NEW YORK, COUNTY OF ss.:

The undersigned being duly sworn, deposes and says:

Deponent is not a party to the action, is over 18 years of age and resides at Staten Island New York

That on the 30th day of June 19 78 deponent served the annexed

Petition for Rehearing

on Glynn L. Mays, Esq., Counsel, Securities & Exchange Commission

attorney(s) for plaintiff-appellee

in this action at 500 North Capital Street N.W. Washington D.C. 20549

the address designated by said attorney(s) for that purpose by depositing a true copy of same enclosed in a postpaid properly addressed wrapper, in ~~a post office~~ — official depository under the exclusive care and custody of the United States post office department within the State of New York.

Sworn to before me

this 30th day of June 19 78

Joan Werring

The name signed must be printed beneath

JOAN WERRING

BERNARD J. COVEN
Notary Public, State of New York
No. 30-5638200
Qualified in Nassau County
Commission Expires March 30, 1979

C 321—Affirmation of Service by Mail: Affidavit of Service by Mail on Reverse Side.

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80 EXCHANGE PLACE AT BROADWAY, NEW YORK

Index No.

Plaintiff

against

Defendant

ATTORNEY'S AFFIRMATION OF SERVICE BY MAIL

STATE OF NEW YORK, COUNTY OF ss.:

The undersigned, attorney at law of the State of New York affirms: that deponent is attorney(s) of record for

That on the day of 19 deponent served the annexed